



Michigan Bankers Association

Senate Bill 234 Senate Finance

September 29, 2015

Good Afternoon Chairman Brandenburg and members of the Senate.

Senate Bill 234 is a result of emerging difficulties in the filing of, and the administrative processing of, business taxes banks remit to the state of Michigan.

History

Currently, bank taxing is a carryover from the Michigan Business Tax created 2007. It is a tax paid on a bank's capital used as a tax base. There are three questions concerning the tax base that have arisen since 2007 that remain unanswered and are clarified by S 234.

1. How was the term *capital* calculated?

Capital is reported to many differing federal agencies. Capital is a fixed definition shared by those agencies for purposes to assess safety, soundness and compliance with security law. These are audited and protected by laws against miss-statement and for accuracy and consistency. FDIC, SEC, FRB, U.S. Treasury and the Michigan Department of Financial Services all receive reports and calculations of capital for determination of the safety and soundness of a banking institution. There are prison terms for manipulators and violators.

Or there was a thought that bank capital could be calculated specially for Michigan tax liability. To do this a new form of capital calculation was required. Michigan became special with special forms and special procedures. This became a complex process and it became difficult to determine by taxpayer or Treasury if the correct amount was being remitted.

S234 will clarify that the term capital defined by the federal regulatory standard. This assures Michigan taxpayers that the correct tax is paid and assures bank taxpayers that all banks are paying a fair tax. S 234 creates a known tax base.

2. Five Year Tax Base Averaging of the tax base.

This was written into the law in 2007 to provide less volatility of taxes remitted to the state of Michigan.

However, the tax base averaging became a problem in the application of the tax as there are merger and acquisitions. This was not thought through sufficiently. The treatment of the existing tax base, the future tax base and the past tax base of the differing portions or members of a business combination became difficult to provide consistent guidance to tax filers. Questions surround whether past year's business capital of the constituent parts should be brought forward. Are amended returns required in past year tax filings prior to a merger?

Recommendation: The MBA recommends the elimination of tax base averaging and a streamlined form of single year calculation. This will increase remittances to the state of Michigan in the near term as capital has been increasing due to regulatory pressure.



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The MBA has reached accord with the Treasurer concerning the above two issues of tax base calculation and language repairing this is before the committee in S234. A final issue is an issue of tax policy and remains unresolved between Treasury and the MBA.

Water's edge

3. Is the tax base of a corporation in the CIT (of which the Financial Services Tax is a portion) defined as a "to the water's edge tax" or does a differing tax base apply to international financial businesses and their activity only?

Explanation

The CIT (and FIT a derivative thereof) *is a water's edge tax*.

This may be found in 206.601: A term used in this section not defined differently shall have the same meaning when used in comparable context as used in the laws of the United States relating to federal taxes...

206.603. The definition of an affiliated group of financial services is defined as United States persons.

The question is what is a *United States person*?

Nowhere in the Financial Institutions Tax (chapter 13) is the term defined differently. Therefore; based on 206.603 the Internal Revenue Code defines *United States person* as:

(30) United States person

The term "United States person" means—

- (A) a citizen or resident of the United States,
- (B) a domestic partnership,
- (C) a domestic corporation,
- (D) any estate (other than a foreign estate, within the meaning of paragraph (31)), and
- (E) any trust if—
 - (i) a court within the United States is able to exercise primary supervision over the administration of the trust, and
 - (ii) one or more United States persons have the authority to control all substantial decisions of the trust.

Note: Does not include a foreign corporation.



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However, Michigan Treasury has determined by reviewing the language in the Financial Institutions Tax apportionment calculation that Michigan is a beyond the water's edge tax only for financial institutions. This is derived by the words at 206.657.(3) *the gross business factor is a fraction, the numerator of which is the total gross business of the financial institution in this state during the tax year and the denominator of which is the total gross business of the financial institution EVERYWHERE during the tax year.*

The critical word here is everywhere. That is not defined in the statute definitions and may mean "everywhere". Treasury's position is the CIT definition section of US Person as explained does not apply in this specific FIT tax administration. Treasury's position is "everywhere" equals everywhere by common definition. By the Treasury position the method of calculating the tax base must be reengineered from the reading of the apportionment base and applying the common definition of "everywhere". Tax filers are held accountable for this lack of clarity by fines and penalties during audits.

Loss of revenue

As the calculation of international capital in the tax base would adjust taxes remitted by financial institutions and would adjust the apportionment calculation of the tax base, the amount of taxes paid by this group of businesses is difficult to state definitively or refute. Is revenue inclusive of fines and penalties for past lack of understanding? Based on the tax alone a range of tax revenue displaced by the strict adherence to the definitions within the CIT would range from \$7 million to \$13 million.

Recommendation: The MBA asks clarity; since the interpretation has caught many persons unprepared for the uniqueness of the interpretation of law. This ultimately is a decision in the Legislature and the Administration as represented by Treasury requires a consensus.